UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

KATON, INC., **CASE NO. 08-02266-NPO**

DEBTOR. **CHAPTER 11**

MEMORANDUM OPINION AND ORDER GRANTING MOTION OF THE BILCO COMPANY FOR RELIEF FROM THE AUTOMATIC STAY TO COMPLETE ARBITRATION

On October 14, 2008, there came on for hearing (the "Hearing") the Motion of the Bilco Company for Relief from the Automatic Stay to Complete Arbitration (the "Motion") (Dk. No. 30) filed by The Bilco Company ("Bilco"); the Answer and Response to Motion for Relief from the Automatic Stay to Complete Arbitration (the "Answer") (Dk. No. 50) filed by Katon, Inc.[1] (the "Debtor"); and, the Reply of the Bilco Company in Further Support of Motion for Relief from the Automatic Stay to Complete Arbitration (Dk. No. 53). At the Hearing, Mary Clay W. Morgan and Jeffrey R. Blackwood represented Bilco, and Craig M. Geno represented the Debtor. Following the Hearing, the Court requested that Bilco and the Debtor file simultaneous post-trial briefs. Both parties timely filed their post-trial briefs (Dk. Nos. 64 and 66). The Court, having considered the pleadings and the arguments of counsel, finds for the reasons discussed below that the Motion is well taken and should be granted as follows:[2]

[1] The voluntary petition (Dk. No. 1) filed by Katon, Inc. in this bankruptcy proceeding reflects the name of the Debtor as Katon, Inc. f/k/a Klingler Electric Corporation.

[2] The following constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

Jurisdiction

This Court has jurisdiction of the parties to and the subject matter of this proceeding pursuant to 28 U.S.C. § 1334. The Motion is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(G). Notice of the Motion was proper under the circumstances.

Facts

1. In 1993, Bilco, Klingler Electric Corporation ("KEC"), and Klingler International Technologies, S.A. de C.V. a/k/a KIT de Mexico S.A. de C.V. ("KIT"), entered into a collection of agreements (the "1993 Agreements") related to the assembly, packaging, and warehousing of Bilco's products at KEC's and KIT's facilities in Juarez, Mexico, and El Paso, Texas. (Mot. ¶ 2, Ex. 1). As part of the 1993 Agreements, KEC and KIT purportedly agreed, among other things, to use Bilco's equipment to weld, assemble, and package Bilco's products at KIT's manufacturing facilities and to fully comply with all federal, state, and municipal laws and rules, and regulations of the United States and Mexico, including compliance with all applicable labor, tax, customs, environmental, and immigration laws. (Mot. Ex. 1). Two of the agreements comprising the 1993 Agreements contain arbitration provisions requiring Texas law to apply to any dispute between the parties. (Mot. ¶ 2).

2. On or about December 28, 2004, KEC allegedly was administratively dissolved by the Mississippi Secretary of State. (Mot. Ex. 1). Thereafter, Bilco purportedly gave written notice to KEC that one of the agreements contained in the 1993 Agreements would be terminated for cause and requested that its equipment be returned. (Mot. Ex. 1).

3. On October 3, 2007, Bilco filed in the 243rd Judicial District Court for El Paso County, Texas, an action asserting breach of contract claims against KEC, KIT, Anton Klingler

("Klingler"), and Anton K. Klinger, III ("Klingler III") alleging that they had failed to make various tax payments, failed to file various tax returns, failed to deliver Bilco's equipment as requested, and failed to comply with Mexican federal labor and customs laws (the "State Court Action"). In the State Court Action Bilco alleges that "KEC's corporate charter was administratively dissolved in 2004 and [that, consequently,] Klingler and Klingler III personally assumed the performance of, and liability for, the 1993 Agreements." (Mot. Ex. 1). Bilco further asserts in the State Court Action that "KEC and KIT are alter egos of Klingler and Klingler III." (Mot. Ex. 1). Bilco seeks money damages and attorney's fees in the State Court Action. (Mot. Ex. 1).

4. On March 26, 2008, the parties to the State Court Action executed an arbitration agreement, separate and apart from those contained in the 1993 Agreements, whereby they agreed to private arbitration of the State Court Action (the "Arbitration Agreement"). (Mot. ¶ 3).

5. On March 26, 2008, the appointed arbitrator entered a Report of Preliminary Hearing and Scheduling Order. The Scheduling Order was amended on July 29, 2008. As amended, the Scheduling Order provided various dates and deadlines which govern the arbitration, and scheduled a hearing to commence on September 22, 2008. (Mt. ¶ 4).

6. On August 1, 2008, the Debtor, which, as noted, was formerly known as KEC, filed a voluntary petition for relief pursuant to chapter 11 of the Bankruptcy Code. (Dk. No. 1).

7. On August 8, 2008, the Debtor removed the State Court Action to the United States Bankruptcy Court for the Western District of Texas, then filed a Motion to Transfer Venue of the removed action to this Court. Bilco has opposed the Motion to Transfer Venue and has filed a Motion to Remand in the Texas bankruptcy court, seeking to return the State Court Action to the 243rd Judicial Court for El Paso County, Texas. (Mot. ¶ 6).

8. On August 28, 2008, Bilco filed the Motion presently before the Court, seeking relief from the automatic stay[3] in order to complete the ongoing arbitration of the State Court Action and to allow the arbitrator to adjudicate Bilco's breach of contract and alter ego claims.[4] Bilco maintains the claims asserted in the State Court Action are non-core matters and that, as such, this Court must lift the stay to allow the parties to complete the arbitration.

9. The Debtor subsequently filed its Answer, contending that "[c]ertain features of Bilco's claims are core proceedings," (Answer ¶ 11), and that judicial economy and the efficient administration of the bankruptcy case weigh in favor of denying the Motion (Answer p. 3).

Discussion

A. Core vs. Non-core Proceedings

In order to determine whether this Court should compel arbitration, it must first determine whether the State Court Action is a core or a non-core proceeding. A core proceeding is one that "arises under" or "arises in" a case under title 11. 28 U.S.C. § 1334(b). Matters "arising under" title 11 are those based on a right "created or determined by a statutory provision of the Bankruptcy Code." Buckingham v. Baptist Memorial Hospital-Golden Triangle, Inc., 283 B.R. 691, 693 (N.D. Miss. 2002). Proceedings "arising in" a title 11 case "are those that are not based on any right expressly created by title 11, but nevertheless, would have no existence outside of the bankruptcy." Id. (citations omitted). In a core proceeding, a bankruptcy court may refuse to enforce an otherwise applicable arbitration agreement only if enforcement of the agreement would conflict with the

[3] The automatic stay arises in the Debtor's bankruptcy case pursuant to 11 U.S.C. § 362.

[4] In the Motion, Bilco states that it will pursue any collection efforts against the Debtor in this Court. (Mot. ¶ 7).

purpose or provisions of the Bankruptcy Code. Insurance Co. of North America v. NCG Settlement Trust & Asbestos Claims Mgmt. Corp. (In re National Gypsum Co.), 118 F.3d 1056, 1069-70 (5th Cir. 1997). That is, in a core proceeding, a bankruptcy court has discretion to override an arbitration agreement only if "it finds that the proceedings are based on provisions of the Bankruptcy Code that 'inherently conflict' with the [Federal] Arbitration Act or that arbitration of the claim would 'necessarily jeopardize' the objectives of the Bankruptcy Code." MBNA America Bank, N.A. v. Hill, 436 F.3d 104, 107 (2d Cir. 2006) (quoting U.S. Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n, Inc. (In re U.S. Lines, Inc.), 197 F.3d 631, 640 (2d Cir. 1999)); In re Mirant Corp., 316 B.R. 234 (Bankr. N.D. Tex. 2004).

A non-core proceeding is a matter that would exist outside of the bankruptcy, but is "related to" a bankruptcy case. 28 U.S.C. § 1334(b). "An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." Buckingham, 283 B.R. at 693 (quoting In re Goldstein, 201 B.R. 1, 4-5 (Bankr. D. Me. 1996)). "It is generally accepted that a bankruptcy court has no discretion to refuse to compel the arbitration of matters not involving 'core' bankruptcy proceedings under 28 U.S.C. § 157(b) . . . ." In re Gandy, 299 F.3d 489, 495 (5th Cir. 2002); *see also* In re Shores of Panama, Inc., 387 B.R. 864, 865 (Bankr. N.D. Fla. 2008) ("If the proceeding is non-core, the bankruptcy court has no discretion and must compel arbitration.").

B. Breach of Contract Claims

The State Court Action asserts breach of contract claims against the Debtor (formerly known as KEC), KIT, Klingler, and Klingler III. Those claims arose and were being prosecuted in Texas state court prior to the filing of the Debtor's bankruptcy case. At first blush, then, the State Court Action would appear to be a non-core proceeding. Bilco's breach of contract claims "do not depend on provisions in the Bankruptcy Code for their existence [but] [r]ather, they are 'non-core' or 'related' proceedings that would not be in this court but for the filing of the bankruptcy case[]." First Franklin Corp. v. Barkley (In re Anthony), 334 B.R. 780, 787 (Bankr. N.D. Miss. 2005); *see also* Southmark Corp. v. Coopers & Lybrand (In re Southmark Corp.), 163 F.3d 925, 930 (5th Cir. 1999) (finding that non-core proceeding was not a proceeding that could arise only in the context of a bankruptcy, but rather "[i]t is simply a state contract action that, had there been no bankruptcy, could have proceeded in state court."). As such, the Court would have no discretion to refuse to compel arbitration. *See* In re Gandy, 299 F.3d at 495.

C. Alter Ego Claims

However, the State Court Action also includes an allegation that Klingler and Klingler III are alter egos of KEC and KIT. The Court of Appeals for the Fifth Circuit has determined that certain alter ego claims against a corporation's principals may be property of the corporation's bankruptcy estate that only the bankruptcy trustee may assert. *See* S.I. Acquisition, Inc. v. Eastway Delivery Service, Inc. (Matter of S.I. Acquisition, Inc.), 817 F.2d 1142 (5th Cir. 1987). Thus, this Court must determine whether, pursuant to S.I. Acquisition and its progeny, Bilco has asserted alter ego claims which are property of the Debtor's bankruptcy estate.

In S.I. Acquisition, a creditor alleged that the debtor corporation had used its corporate structure "merely as a cloak to conceal fraud, wrongs and injustice, and to insulate [control persons] from legal and financial responsibility for wrongs committed by [the debtor corporation]." S.I. Acquisition, 817 F.2d at 1144. The Fifth Circuit, therefore, examined the alter ego doctrine and stated that, under Texas law, "an alter ego remedy applies when there is such an identity or unity between a corporation and an individual or another entity such that all separateness between the parties has ceased and a failure to disregard the corporate form would be unfair or unjust." S.I. Acquisition, 817 F.2d at 1152. Because the creditor's claims asserted that the control persons' wrongful actions had harmed the debtor corporation itself, the Fifth Circuit determined that the claims belonged to the debtor corporation's bankruptcy estate. The Fifth Circuit stated:

> Since the corporation has an independent existence at law, we do not believe it is inconsistent in light of the above policy to say that a corporation may pierce its own corporate veil and hold accountable those who have misused the corporation in order to meet its corporate obligations.

Id.

In Schertz-Cibolo-Universal City, Indep. School Dist. v. Wright (Matter of Educators Group Health Trust), the Fifth Circuit expounded:

> Whether a particular cause of action belongs to the estate depends on whether under applicable state law the debtor could have raised the claim as of the commencement of the case. As part of this inquiry, we look at the nature of the injury for which relief is sought. If a cause of action alleges only indirect harm to a creditor (i.e., an injury which derives from harm to the debtor), and the debtor could have raised a claim for its direct injury under the applicable law, then the cause of action belongs to the estate. . . . Conversely, if the cause of action does not explicitly or implicitly allege harm to the debtor, then the cause of action could not have been asserted by the debtor as of the commencement of the case, and thus is not property of the estate.

Matter of Educators Group Health Trust, 25 F.3d 1281, 1284 (5^{th} Cir. 1994) (citations omitted). A cause of action which alleges harm to the debtor is one that is "created for the benefit of the corporation, i.e., to vindicate an injury to the corporation caused by the misdeeds of control persons." Nick Corp. v. JNS Aviation, Inc. (In re JNS Aviation, LLC), 350 B.R. 283, 290 (Bankr. N.D. Tex. 2006) (citing S.I. Acquisition, 817 F.2d at 1149).

In the case at bar, Bilco alleges that the Debtor failed to maintain its corporate charter and that, as a result, Texas law mandates that Klingler and Klingler III are liable for the Debtor's breach of contract. The Texas statute upon which Bilco's relies states as follows:

> If the corporate privileges of a corporation are forfeited for the failure to file a report or pay a tax or penalty, each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived.

Tex. Tax Code Ann. § 171.255(a) (Vernon 2002). Thus, Bilco contends that, by virtue of the Texas statute, Klingler and Klingler III are personally liable for the Debtor's breach of contract "in the same manner and to the same extent as if the director or officer were a partner and the corporation were a partnership." In re Wool Growers Central Storage Co., 371 B.R. 768, 780 (Bankr. N.D. Tex. 2007) (quoting Tex. Tax Code Ann. § 171.255(a) (Vernon 2002)). Bilco, then, does not allege that Klingler and Klingler III abused the Debtor's corporate form or otherwise caused harm to the Debtor, but rather that Klingler and Klingler III are passively liable to Bilco for breach of contract due to the purported lapse of the Debtor's corporate charter.

In the recent case of In re Wool Growers Central Storage Co., the Bankruptcy Court for the Northern District of Texas decided that a creditor's breach of contract claims against a debtor corporation's officers and directors pursuant to Tex. Tax Code Ann. § 171.255(a) are not property of the corporation's bankruptcy estate. In re Wool Growers Central Storage Co., 371 B.R. 768, 780 (Bankr. N.D. Tex. 2007). Distinguishing the S.I. Acquisition case, the bankruptcy court noted that the "nature of the conduct giving rise to an alter ego claim is very different that the conduct (or lack of conduct) that causes the forfeiture of a corporate charter." In re Wool Growers, 371 B.R. at 778-781.

Thus, based on the foregoing, the Court finds that Bilco has not asserted alter ego claims which allege direct harm to the Debtor. Consequently, S.I. Acquisition is not applicable to the case at bar, and the alter ego claims contained in the State Court Action do not belong to the Debtor's bankruptcy estate. Accordingly, the State Court Action does not constitute a core proceeding as a result of the asserted alter ego claims.

D. Discretionary Even if Core

Yet, even if the State Court Action somehow did constitute a core proceeding, this Court would not exercise its discretion to override the Arbitration Agreement. *See* Whiting-Turner Contracting Co. v. Electric Mach. Enter., Inc. (In re Electric Mach. Enter., Inc.), 479 F.3d 791 (11th Cir. 2007) ("[E]ven if a proceeding is determined to be a core proceeding, the bankruptcy court must still analyze whether enforcing a valid arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code."). In this case, the State Court Action is comprised of breach of contract and alter ego claims based solely on Texas law. The claims arose outside of the Debtor's bankruptcy and are not based on any provision of the Bankruptcy Code. Enforcement of the Arbitration Agreement would not jeopardize the objectives of the Bankruptcy Code. In fact, the arbitration appears to have been nearing completion prior to the filing of the Debtor's bankruptcy petition, weighing in favor of judicial economy. The Court thus determines that enforcement of the Arbitration Agreement would not inherently conflict with the underlying purposes of the Bankruptcy Code, and finds that it would not exercise its discretion to refuse to enforce the Arbitration Agreement.

Conclusion

Based on the foregoing, the Court concludes that the breach of contract and alter ego claims raised by Bilco against the Debtor in the State Court Action are non-core, "related to" claims and that, consequently, the Court does not have discretion to refuse to compel arbitration. Accordingly, the Court finds that the automatic stay should be lifted to allow the pending arbitration proceeding to be completed through adjudication of Bilco's claims. However, any collection efforts against the Debtor should be pursued in this Court.

A separate final judgment will be entered in accordance with Federal Rule of Bankruptcy Procedure 9021.

IT IS, THEREFORE, ORDERED that the Motion is granted as set forth herein.

SO ORDERED, this the 13th day of November, 2008.

/ s / Neil P. Olack
NEIL P. OLACK
U. S. BANKRUPTCY JUDGE